No. 9735.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE D. MARTIN, as Internal Revenue Agent in charge for the Sixth United States Internal Revenue Collection District of California,

Appellant,

vs.

CHANDIS SECURITIES COMPANY and H. E. DOWNING, as assistant secretary of Chandis Securities Company,

Appellees.

SECOND BRIEF FOR APPELLANT.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.
HELEN R. CARLOSS,
FRANK J. READY,
Special Assistants to the Attorney General.
Department of Justice, Washington, D. C.

WILLIAM FLEET PALMER,
United States Attorney.
E. H. MITCHELL,
Assistant United States Attorney.
EUGENE HARPOLE,
Special Attorney, Bureau of Internal Revenue.
SAMUEL TAYLOR,
Special Attorney, Bureau of Internal Revenue.

Parker & Baird Company, Law Printers, Los Angeles.

TOPICAL INDEX.

PAGE

PAGE

TABLE OF AUTHORITIES CITED.

PAGE

STATUTES.

No. 9735.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE D. MARTIN, as Internal Revenue Agent in charge for the Sixth United States Internal Revenue Collection District of California,

Appellant,

vs.

CHANDIS SECURITIES COMPANY and H. E. DOWNING, as assistant secretary of Chandis Securities Company,

Appellees.

BRIEF FOR APPELLANT.

Statement of the Pleadings, Facts and Procedural Steps Disclosing Jurisdictions.

This case arises on appeal from an order and judgment entered by the District Court of the United States for the Southern District of California, Central Division. [R. 157-159.] The opinion, by Judge Yankwich [R. 152-157], is reported in 33 F. Supp. 478.

The facts and matters disclosing the basis upon which it is contended that the District Court had jurisdiction to grant the relief sought in this proceeding, as disclosed by the petition and the affidavits and exhibits submitted in support thereof at the hearing [R. 2-13, 73-78, 148-149] are summarized below; the proceedings had both prior and

subsequent to the entry of the order and judgment from which this appeal was taken, and which are relied upon as the basis for invoking the jurisdiction of this Court to review that order and judgment, are briefly outlined; and the statutory provisions believed to sustain both jurisdictions are briefly referred to. These are all as follows:

(a) Jurisdiction of District Court.

Appellant, who was petitioner in the court below, is the United States Internal Revenue Agent in Charge in and for the Sixth Internal Revenue Collection District with office and post of duty in the City of Los Angeles, California. He is the Internal Revenue agent and field officer of the Bureau of Internal Revenue who is designated and authorized by the Commissioner of Internal Revenue to make the investigation of tax liability herein involved. [R. 2-3, 8-9.][1]

The appellee, Chandis Securities Company (hereinafter referred to as Chandis) is a private family corporation domiciled in the City of Los Angeles, California [R. 3-4], whose entire outstanding capital stock is owned by the family of Harry Chandler in the proportion of 40% by Mrs. Marian Otis Chandler (the taxpayer), 56% divided

---

[1]Internal Revenue Code (U. S. C., Supp. V, Title 26), Sec. 3901(a)(1) provides that the Commissioner of Internal Revenue, under the direction of the Secretary of the Treasury "shall have *general superintendence* of the assessment and collection of all taxes imposed by any law providing internal revenue." (Italics supplied.)

Section 4000 thereof also provides that the Commissioner may, whenever in his judgment the necessities of the service so require, employ competent agents who shall be known as internal revenue agents, and Section 4001 thereof provides further that—

> The Commissioner may, at his discretion, assign any agent whose employment is authorized by the preceding section to duty under the direction of any officer of the internal revenue, or to such other duty as he may deem necessary.

equally among the eight Chandler children and 4% by Mr. Chandler. [R. 51-57.]

The appellee, H. E. Downing, is the assistant secretary of Chandis, has his office and residence in the City of Los Angeles, California, and also is the custodian of the books, records and papers sought to be examined herein. [R. 4, 24.] He is also asserted to have knowledge of certain business transactions of Mrs. Marian Otis Chandler affecting her individual income tax liability for the year 1930 now under inquiry by the Bureau of Internal Revenue. [R. 4, 12-13, 73-78, 148-149.]

The taxpayer is not a party to this proceeding.

On March 31, 1938, the acting Commissioner of Internal Revenue addressed to the taxpayer, Marian Otis Chandler, a written request for a re-examination of her books and records for the reason that it was deemed necessary in order to properly verify her income tax return for the year 1930 [R. 9] and caused the same to be delivered to her by a local internal revenue agent on November 30, 1939. [R. 25.] This action was taken pursuant to the provisions of Section 1105 of the Revenue Act of 1926 (now Section 3631, Internal Revenue Code, Appendix, *infra*). The taxpayer refused and still refuses to comply with the Commissioner's request. [R. 25, 34-35.]

The Commissioner designated appellant and his assistants or the internal revenue agents working under his immediate supervision as the officers or employees of the field service of the Bureau of Internal Revenue who should on his behalf examine "any books, papers, records,"

etc., for the purpose of ascertaining the correctness of the taxpayer's return and who should require the attendance and testimony of any person "having knowledge in the premises." This designation was made pursuant to the provisions of Section 3614, Internal Revenue Code (Appendix, *infra*).[2]

Acting under such authority and direction, in the name of the Commissioner of Internal Revenue and pursuant to the provisions of said Section 3614 of the Internal Revenue Code, appellant on November 30, 1939, issued and caused to be duly served upon the appellees a written instrument entitled "Summons to Appear to Testify and to Produce Books, etc.," requiring them to appear before him at a designated place on December 11, 1939, to then and there give testimony in the matter of the taxpayer's 1930 income tax liability, and to produce certain records therein described. [R. 4-5, 10-11.] Appellees refused to respond to such summons. [R. 6-7.]

On March 5, 1940, this proceeding was commenced in the District Court pursuant to the provisions of Section 3633 of the Internal Revenue Code (Appendix) to compel such attendance, testimony and production of records. [R. 2-13.] The petition was filed with the authority and sanction of the Commissioner of Internal Revenue and at the request of the Attorney General of the United States. [R. 2-3.] That was done under the authority granted by Section 3740, Internal Revenue Code (Appendix, *infra*).

---

[2]In acting Commissioner Carter's letter to the taxpayer which he caused to be personally served upon her by local internal revenue agents acting under appellant's immediate supervision as just pointed out, he asks the taxpayer to "permit our representatives to have access to all your books and records" and to "cooperate fully with them" in the requested re-examination. [R. 9.]

(b) Jurisdiction of This Court.

In his petition appellant prayed that an order issue requiring appellees to appear at the place designated on March 11, 1940, to testify and to produce the records listed in said summons. [R. 7-8.][3] No other relief was sought. An order, as so prayed, was issued *ex parte* on March 5, 1940. [R. 13-16.] The return date was, by court order, duly continued to April 8, 1940 [R. 16-18], and appellees made a timely motion to quash such order. [R. 19-24.] Affidavits in support of the motion to quash [R. 24-37, 136-140, 150-151] with voluminous exhibits thereto [R. 37-73, 165-221, 222-256] were submitted to the District Court by the appellees, and counter-affidavits in opposition to that motion and in support of the petition and order theretofore issued thereon [R. 9-13, 73-79, 141-149] and exhibits attached thereto [R. 80-135] were submitted by appellant.

On June 10, 1940, the District Court filed its memorandum opinion (1) holding that appellant was not entitled to any relief against appellees under the petition and supporting affidavits; and (2) directing that the *ex parte*

---

[3]The list of records set forth in that summons [R. 10-11] and copied into the petition [R. 5] is as follows:

> Records of Chandis Securities Company for the years 1916 to 1930, inclusive, as follows: Minute books; capital stock certificate books, ledgers and journals; all accounting books and records including general ledgers, together with all vouchers, correspondence and other written data supporting the original entries in said accounting books; all promissory notes of Chandis Securities Company issued, assigned, endorsed, or otherwise transferred during said years to Marian Otis Chandler, Franceska Chandler Kirkpatrick, May Chandler Goodan, Helen Chandler, Philip Chandler, Ruth Chandler Williamson, Harrison Gray Chandler, Constance Chandler, and Norman Chandler which have been paid or otherwise cancelled.

order for production of records be quashed and annulled "without prejudice * * * to a new application upon a new petition" and upon a proper showing limited both in point of time and to matters required to be included in the return of the taxpayer "with special reference to the particular transaction * * * under investigation." [33 F. Supp. 478; R. 152-157.]

The order and judgment entered by the District Court to the same effect on the same date [R. 151-152] is the one from which this appeal is taken. [R. 157-158.]

Appellant served and filed notice of appeal from that decision to the Circuit Court of Appeals for this Circuit on September 6, 1940. [R. 157-159.] The District Court on October 4, 1940, extended the time for filing the record in this Court and docketing the cause on appeal to and including December 5, 1940. [R. 159.]

All further necessary extensions were obtained under timely orders, signed and entered by judges of this Court on December 5, 1940, February 1, 1941, and February 24, 1941, respectively, in order to render timely (1) the service and filing of appellant's statement of points on appeal on December 31, 1940 [R. 160-162], (2) the settlement and certification of the record in the court below [R. 258-266], and (3) the filing of the transcript of the record of the District Court in this Court and the docketing of the cause on appeal here on February 3, 1941. [R. 257.]

The jurisdiction of this Court to review the decision of the trial court upon this appeal is invoked under Section 128(a) of the Judicial Code, as amended (Appendix *Infra,* p. 66).

STATEMENT OF THE CASE.

Questions Presented.

The first two questions presented have been raised by this Court upon its own motion at a former hearing of this cause on February 24, 1942, although not noticed in the appellees' brief. They involve the jurisdictions of both the District Court and of this Court, respectively, and are as follows:

1. Did the District Court have jurisdiction under the provisions of Section 3633, Internal Revenue Code, to grant relief of the nature prayed in the petition?

2. Is the order and judgment entered by the District Court on June 10, 1940, a "final decision" by that Court which is subject to review on an appeal taken therefrom to the United States Circuit Court of Appeals for the Ninth Circuit within the purview of Section 128(a) of the Judicial Code as amended?

The other three questions involve the merits and arose in this manner. Acting through appellant as his designated field representative, the Commissioner of Internal Revenue sought judicial process for the enforcement of an administrative summons and subpoena *duces tecum* enabling him to make a second examination of the books and records of a family holding corporation. The Commissioner's purpose was twofold: *first,* to ascertain whether there was actual fraud in the failure of the principal shareholder in the corporation to include in her individual income tax return for the calendar year 1930 a large amount of interest previously accrued upon promissory notes of the corporation and paid to the taxpayer through

the culmination in 1930 of a series of transactions between the corporation and its shareholders which extended over a long period of years antedating that taxable year, and *second,* if he found fraud had existed, and hence that the assessment of a deficiency for that year was not barred by the statute of limitations, to determine whether and to what extent a tax deficiency should be proposed against the shareholder upon the basis of the asserted interest income for that year. [R. 2-13.] The District Court, after a hearing and submission upon all the issues raised by the respective parties under the form of procedure hereinbefore described, held that appellant was not entitled to any relief under the petition herein but without prejudice to the right of appellant to commence a new proceeding by filing a new petition seeking relief of a more limited nature than sought herein. [R. 151-152.] The questions thereby presented are as follows:

> 3. Did the Commissioner make a sufficient showing of probable cause, sometimes called reasonable grounds for suspicion of fraud, to justify his requested re-examination of the appellee corporation's books and records reflecting its transactions with the stockholder taxpayer herein involved?
>
> 4. Is either the appellee corporation or its assistant secretary in a position to raise any question in this proceeding as to whether the Commissioner's requested examination of its corporate records of transactions with its chief stockholder is unreasonable, unnecessary, or futile because of the limitation against assessment of a deficiency, where the taxpayer is not before the Court, and, concededly, cannot be bound by any determination herein?

5. Should the Commissioner be limited in his examination either as to particular books and records of the appellee corporation or as to any transactions leading up to or forming part of those between the taxpayer and the corporation which are now in question, by reason of such transactions having occurred prior to any fixed, arbitrary date?

Statutes and Court Rules Involved.

These are set forth in the Appendix, *infra,* pages 65-68.

Statement of the Facts.

Undisputed Historical Facts.

In 1916, Harry Chandler organized the appellee Securities Company as a family holding corporation domiciled in California with original authorized capital stock of 500 shares aggregating the par value of $500,000. He caused 40% of its stock to be issued to his wife (the taxpayer here), and 56% in equal proportions to his eight children. Shortly thereafter Mr. Chandler transferred certain investment properties to the corporation in consideration of its interest-bearing promissory notes and assigned the notes to his wife and children in proportion to their shareholdings in the corporation. [R. 50-51, 58-61.]

On December 31, 1923, when the principal sum of all the notes so assigned amounted to $1,938,548.60, and interest had accrued thereon of $702,049.61, aggregating $2,640,598.21, the first series of notes was surrendered and new notes were issued by the appellee corporation to Mrs. Chandler and the children, respectively, in principal

sums aggregating $2,640,598.21. The new notes were to mature December 31, 1929, and bore interest at 5% per annum, compounded annually. [R. 31-53.] Under that arrangement the taxpayer cancelled and surrendered old notes for the total principal sum of $810,687.06 upon which interest of $294,950.76 had accrued to December 31, 1923, and received new interest-bearing notes for the aggregate principal sum of $1,105,637.82. [R. 44-45, 51-53.] The new notes matured December 31, 1928. [R. 222-224.] The company kept its books upon the accrual basis, but did not accrue the interest upon the notes thus held by its stockholders as such interest originally became due yearly. However, in 1923, the company set up on its books the total amount of all such interest accumulated during the preceding six years. The taxpayer had made her returns during that same period upon the cash receipts and disbursements basis. [R. 60.]

When the Commissioner attempted to assess income tax against the shareholder payees of the first series of notes to the extent of interest thus included in the face of the new notes received by them on December 31, 1923, the Board of Tax Appeals on June 29, 1929, disallowed the proposed deficiencies for 1920-1923, holding that the payees of the new notes had not constructively received any interest income in the 1923 transaction. (*Chandler v. Commissioner,* 16 B. T. A. 1248.) [R. 58-67.]

Thereafter, when interest in the total sum of $875,-008.67 had accrued to and including December 31, 1929, upon the second series notes for the total principal sum of

$2,640,598.21, making aggregate principal and interest then due thereon of $3,515,606.88, all of those notes were cancelled and surrendered, and the company issued 35,156 additional shares of its capital stock of the par value of $100.00 each, aggregating $3,515,600.00, to the respective payees of those notes in full settlement of the indebtedness for principal and interest represented by its notes. [R. 52-57.]

Under that arrangement the taxpayer surrendered her notes dated December 23, 1923, for the aggregate principal sum of $1,105,637.82, maturing December 31, 1928, upon which compound interest of $366,418.80 had been accrued to December 31, 1929, aggregating $1,472,056.62 [R. 45] and received and accepted 14,721 shares of stock of Chandis of the aggregate par value of $1,472,100.00 [R. 45, 47] in full settlement of her notes and accrued interest thereon. [R. 52-57, 222-226.] The newly issued shares of stock were stipulated (in a former proceeding before the Board of Tax Appeals involving the taxpayer's 1929 tax liability and hereinafter mentioned) to be worth $60.00 per share. [R. 55-56.]

From 1924 to 1929, inclusive, Chandis accrued the prescribed interest upon this second series of its notes and deducted that interest upon its annual income tax returns for those years. [R. 55.] The individual shareholders constituting the ultimate payees of both series of notes kept their books and made their returns of annual income upon the cash receipts and disbursements basis. Those

individuals never reported any item of interest from this source as taxable income, nor have they ever paid any tax upon any interest income of this nature. Chandis has deducted from its returned gross income corresponding amounts as interest expense for all the years 1918 to 1929, inclusive. [R. 55, 59-67.] However, Chandis never charged itself upon its books with any interest accruing upon those notes after December 31, 1929, and has never deducted any interest accruing upon those notes after that date from its reported gross income for any taxable year. [R. 200.]

The taxpayer filed her individual income tax return for the calendar year 1929 on March 15, 1930 [R. 100], and filed her 1930 income tax return on March 16, 1931. [R. 112.]

On November 25, 1931, the taxpayer was furnished a copy of a report of an internal revenue agent recommending a deficiency assessment against her for the year 1929 upon the basis, *inter alia,* that she had received unreported interest income during that year from the transactions above described. [R. 78, 83-85.] On December 17, 1931, the taxpayer filed with the Internal Revenue Agent in Charge at Los Angeles her own affidavit admitting that Chandis had acquired its promissory notes just mentioned from her *"during the calendar year 1929"* but protesting upon grounds not material here that the transaction did not give rise to any taxable income to her during that period. [R. 87-89.] A supplementary letter was also sent to the Internal Revenue Agent in Charge by her representatives on March 28, 1932, merely amplifying her protest that the issuance of stock in payment of notes of

Chandis had not resulted in taxable income to the taxpayer. [R. 90-91.][4]

The permit issued by the Commissioner of Corporations of California on December 26, 1929, under the laws of California[5] granting application of Chandis to issue additional shares of stock for this purpose required that the exchange "should involve simultaneous cancellation of the notes and issue of stock—that the cancellation and issuance were to coincide in time." [R. 52-57.]

The former Internal Revenue Agent in Charge at Los Angeles acknowledged receipt of both of the taxpayer's communications by letter to the taxpayer dated April 4, 1932, stating the protests were being referred to the Bureau at Washington, D. C. He also clearly indicated that the field office was submitting the matter to Washington upon the basis that payment of the notes with shares of stock of Chandis was a taxable transaction consummated by the taxpayer *during the year 1929*. [R. 78, 92-94.]

On July 1, 1932, the Commissioner issued statutory sixty-day notice to the taxpayer of a deficiency in her 1929 income tax upon the basis that she had received unreported interest income from Chandis during that year of

---

[4]The taxpayer's only objection to the proposed deficiency for 1929 at that time was that the payment of the maker's promissory notes with shares of its own corporate stock was a nontaxable exchange under Section 112(b) (5) of the Revenue Act of 1928, c. 852, 45 Stat. 791. [R. 88, 91.]

[5]Statutes and Amendments to the Codes, California, 1917, c. 532 (Act of May 18, 1917), pp. 673, 679:

> Sec. 12. *Securities void.* Every security issued by any company, without a permit of the commissioner authorizing the same then in effect, shall be void, and every security issued by any company, with the authorization of the commissioner but not conforming in its provisions to the provisions, if any, which it is required by the permit of the commissioner to contain, shall be void.

$661,369.56 [R. 67, 69]; and the taxpayer appealed to the United States Board of Tax Appeals from that determination of deficiency.

The taxpayer's individual income tax return for the year 1930 had been filed on March 16, 1931, as already stated [R. 112], so that the two year statute of limitations for assertion of any tax deficiency for that year expired on March 16, 1933, in the absence of fraud.[6]

After the expiration of that time, and on September 25, 1933 [R. 173], the taxpayer filed an amended petition with the Board of Tax Appeals in her 1929 case setting up for the first time the contentions (a) that she had neither cancelled and surrendered her notes nor received any shares of stock therefor during the taxable year 1929; (b) that such transaction had been consummated as to both interested parties entirely in the year 1930; and (c) that the transaction could not give rise to taxable income to her during the year 1929 in any event. [R. 167, 201-202.] She then broadened her attack upon the proposed 1929 deficiency by adding other grounds not material herein. [R. 165-173.] Similar amended petitions were likewise filed with the Board in the companion cases of the taxpayer's eight children. Upon the hearing of the consolidated appeals the Board, on June 7, 1935, found that neither the cancellation and surrender of the notes nor the issuance of the additional shares of stock had taken place until 1930, and disallowed the proposed deficiencies without considering any other phase of that transaction.[7] Upon appeal by the Commissioner, this Court affirmed the Board's decision

---

[6]Sections 275(a) and 276(a), Revenue Act of 1928, Appendix, *infra*.

[7]*Chandler v. Commissioner*, 32 B. T. A. 720. [R. 29, 50-57.]

without consideration of any question except the sufficiency of the evidence to sustain the Board's finding that the transaction was not consummated during the taxable year 1929.[8]

In the 1929 case, the Board made evidentiary findings (a) that the notes in question were in the custody of the appellee Downing (who was then secretary of Chandis) throughout the year 1929; (b) that the balance sheet of Chandis on December 31, 1929, listed the notes among its liabilities; (c) that the books of Chandis contained appropriate entries to show consummation of these transactions in 1930; (d) that the notes were surrendered and cancelled on January 2, 1930; (e) that the stock certificates were issued "on that day or later in that month, but as of January 2, 1930"; and (f) that the stock certificates were delivered in May, 1930. [R. 55-57.] The three cancelled notes put in evidence by the taxpayer before the Board and also stipulated into the record herein bear identical typewritten notations or endorsements across their face, signed by the taxpayer and reading as follows [R. 222-224]:

January 2, 1930

The Receipt Of Capital Stock Of Chandis Securities Company In Full Settlement Of Principal and Accrued Interest To December 31, 1929 Is Hereby Acknowledged.

(Signed) MARIAN OTIS CHANDLER.

At the hearing of the taxpayer's 1929 case before the Board the appellee Downing testified as a witness in her

---

[8]*Commissioner v. Chandler,* 89 Fed. (2d) 332 (C. C. A. 9th). [R. 29.]

behalf. Upon cross-examination he admitted (a) that he had been with Chandis since its organization in 1916 and with the Chandler family since 1902; (b) that all the books and records of Chandis, together with its promissory notes above described, had been in his custody during the entire year 1929; (c) that all such books, papers and records were kept by him during that period in one safe which belonged to another corporation; and (d) that such safe had been kept in the offices of that other corporation in a room assigned to Downing for use in transacting the business of Chandis. [R. 196-197.]

Broadly speaking, the above described events and proceedings constituted the historical background and basis for the Commissioner's determination that it was necessary to re-examine into the individual income tax case of Mrs. Marian Otis Chandler for the year 1930 and to seek the aid of judicial process in that re-examination when the interested parties denied his representatives access to the pertinent records for that purpose. Other phases of the merits, including a direct and material issue of veracity as between Revenue Agent Donnally [R. 73-76, 141-147] and the appellee Downing [R. 136-140] are set forth hereinafter under the appropriate subheading.

Further Showing of Basis for Relief, Proceedings at Hearing, and Finality of District Court's Decision.

The events and proceedings subsequent to those just described are stated below without repetition of matters already referred to any further than necessary to show here the full picture presented to the trial court as follows:

Appellant duly served the taxpayer with the Commissioner's statutory written notice of the Commissioner's determination that it was necessary for his agents to make a re-investigation of her 1930 income tax case. [R. 9, 25.] The interested parties refused to submit to the requested examination of their records. [R. 6-7, 25, 34-45.] Appellant, acting in the Commissioner's name, and under his direction then issued and served upon appellees the administrative summons already described directing the submission for his examination of the books, papers and records listed in the margin under footnote 3, *supra,* and to testify relative thereto. [R. 5, 10-11.] Appellees refused to respond thereto. [R. 6-7.] Appellant then filed in the District Court on March 5, 1940, the petition herein, praying solely that appellees be ordered by the court to appear before appellant at his office at 10 o'clock A. M. on March 11, 1940, produce the same records and give the same testimony called for under the aforesaid summons and order. [R. 2-13.] On the same date the District Court issued an *ex parte* order as prayed. [R. 13-16.] Within the return day as extended [R. 16-18] appellees moved to quash that order. [R. 19-24.]

Technically and strictly speaking, the cause was heard and submitted upon a motion to quash the *ex parte* order. However, with at least the tacit approval of the trial court, the parties for all practical purposes undertook to submit the whole controversy to the trial court then and there for determination upon the merits. They presented numerous affidavits (some of which were violently conflicting as to material phases of the case) and voluminous documentary exhibits in support of their respective versions of the disputed factual matters as well as in explana-

tion of the historical background of the case which is largely a matter of record and not in dispute. [R. 24-256.]

These various affidavits and documents are summarized as follows:

The petition includes and is supported by an affidavit of Revenue Agent W. E. Williams, stating (1) that the Government was attempting to determine why certain asserted interest income received by the taxpayer from the appellee corporation in excess of $650,000 had not been reported in her income tax return for the calendar year 1930; (2) that most of the facts in connection with the receipt of this asserted interest income, the manner of its accrual and its value at the date of receipt for taxation purposes are contained in the books and records of the appellee corporation; (3) that the appellee Downing has unusual personal knowledge of those transactions; and (4) that the requested administrative examination of those corporate books and records and oral examination of the appellee Downing is necessary "in order to determine" whether the taxpayer committed a fraud against the revenue by failing to report in her 1930 income tax return "a large sum of asserted interest income received by her" from the appellee corporation in the year 1930. [R. 12-13.]

At the hearing appellees submitted in their behalf (a) Downing's affidavit dated March 19, 1940 [R. 24-37] with voluminous exhibits thereto [R. 37-73]; (b) Downing's second affidavit filed April 19, 1940 [R. 136-140]; (c) Downing's "counter-affidavit" filed May 14, 1940 [R. 150-151], and (d) "Respondent's Exhibit A" consisting of amended pleadings and excerpts from the record in the

1929 case of the taxpayer [R. 165-221], and certain documents put in evidence before the Board of Tax Appeals in that proceeding. [R. 222-256.]

Appellant submitted at the hearing in his behalf (a) his own verification of the petition, the affidavit of Revenue Agent Williams just mentioned and other exhibits to the petition [R. 8-13]; (b) affidavit of Revenue Agent Donnally dated April 5, 1940 [R. 73-76]; (c) a second affidavit of Williams dated April 6, 1940 [R. 76-79], and exhibits thereto [R. 80-135]; (d) a second affidavit of Donnally filed May 3, 1940 [R. 141-147], and (e) a third affidavit of Williams filed May 10, 1940. [R. 148-149.][9]

Under the various affidavits and exhibits thus submitted on the motion to quash, appellant made a showing of the existence of certain evidentiary facts material to the question of probable cause or reasonable ground for the Commissioner's suspicion of fraud in the taxpayer's 1930 income tax return (and without any serious attempt at contradiction by appellees) substantially as follows:

(a) A revenue agent acting under the Commissioner's direction made a field examination of the taxpayer's

---

[9]Under the Federal Rules of Civil Procedure for the District Courts of the United States, Rule 10(c) (Appendix, *infra*) the affidavits and documents made exhibits to the petition are "part thereof for all purposes," and more especially for the purpose of any hearing at which the sufficiency of the petition is involved. Cf. *Simmons v. Peavy-Welsh Lumber Co.*, 113 F. (2d) 812 (C. C. A. 5th); *Pelelas v. Caterpillar Tractor Co.*, 113 F. (2d) 629 (C. C. A. 7th). In view of the spirit and intent of these new rules, as specifically asserted in Rule 1 (also Appendix, *infra*) that "they shall be construed to secure the just, speedy, and inexpensive determination of every action," and the way the parties, with the benediction of the trial judge, submitted their respective evidence and legal contentions to the trial court in this somewhat unusual but nevertheless practical manner for this peculiar type of statutory proceeding, it is submitted that this Court may properly treat the decision now appealed from as one intended by the trial court and accepted by the parties as a final determination of the case in the District Court. This feature is further noticed in our argument hereinafter.

individual 1929 income tax return and submitted a report on or about November 25, 1931, recommending a deficiency assessment against her for that year upon the basis that the payment or settlement by the appellee corporation of its notes and interest due thereon with shares of its own stock had resulted in unreported taxable income to the taxpayer for that year. [R. 78, 80-85.]

(b) After the taxpayer received copy of that report she submitted a sworn protest dated December 17, 1931, to the former Internal Revenue Agent in Charge at Los Angeles and represented to the Bureau in her own affidavit that the transaction in question took place "during the calendar year 1929" but was merely a non-taxable or exempt exchange under the income tax laws. [R. 87-89.]

(c) Her representatives thereafter on March 28, 1932, and April 4, 1932, exchanged letters with the Internal Revenue Agent in Charge upon the same basis while her 1929 tax liability was still under consideration. [R. 90-93.] In his letter bearing the latter date, the Agent in Charge informed the representative of the taxpayer that the revenue agent's report and her protests regarding her 1929 case had been forwarded to the Commissioner at Washington "for consideration and appropriate action", and furnished her a recomputation of her 1929 tax liability as then recommended to the Bureau by the field office, treating the above transaction as having been consummated in 1929. [R. 92-94.]

(d) The Commissioner relied upon these representations of the taxpayer when on July 1, 1932, his statutory sixty-day deficiency notice was issued asserting she had

received unreported interest income of $661,369.56 during that year from the same transaction. [R. 67, 69, 71.]

(e) After the taxpayer appealed to the Board of Tax Appeals from the deficiency thus proposed in 1932 for the year 1929, she delayed or waited until August, 1933, before her representatives notified counsel for the Bureau in that proceeding of her change in position from what was stated in her affidavit of December 17, 1931. [R. 201-202.] On September 25, 1933, she filed an amended petition with the Board asserting that the exchange of notes for stock was consummated during 1930 and hence in 1929 could not give rise to a deficiency for 1929. [R. 165-173.]

(f) By thus waiting or delaying until August, 1933, to give the Commissioner notice of that change in her position, she misled the Commissioner as to the vitally material fact whether the transaction in question was consummated in that taxable year or in a later one not then directly under consideration by the Bureau. As a result of being so misled by the taxpayer's own personal misleading statement of material facts, the Bureau relied upon that representation of material facts, until the Commissioner had lost the right to test out on the merits either before the courts or the Board of Tax Appeals under a timely asserted tax deficiency for the year 1930 the question whether the taxpayer had received over a half million dollars of asserted unreported interest income during either year. [R. 75-76; 80, 82-85; 87-89; 90-91; 67, 69-71; 201-202.]

As already indicated, an issue of veracity developed at the hearing as between the affidavits of Revenue Agent Donnally of April 5, 1940 [R. 73-76], and of May 2,

1940 [R. 141-147], and the affidavits of the appellee Downing of April 19, 1940 [R. 136-140], and of May 14, 1940 [R. 150-151].

Revenue Agent Donnally's first affidavit [R. 73-76] substantially is as follows:

(1) That while acting in his official capacity he made an investigation and report on the 1929 income tax liability of the taxpayer; (2) that in the course of that investigation and on or about September 15, 1931, he went to her residence in Los Angeles as given in her 1929 return and demanded to see her about that return; (3) that he was instructed at her residence to see the appellee Downing as the taxpayer's representative "with regard to her income tax returns", and was told that Downing would furnish whatever information Donnally desired respecting the same; (4) that he called upon the appellee Downing for that purpose; (5) that Downing informed Donnally he had charge, for the taxpayer, of matters pertaining to her income tax return and that Downing would answer any questions Donnally had with regard to her 1929 return; (6) that Agent Donnally then requested Downing to produce all the books and records and documents pertaining to the exchange by the taxpayer and by other members of the Chandler family of their notes owing by the appellee corporation for shares of its stock; (7) that Agent Donnally specifically requested Downing to produce the notes which were supposed to have been cancelled in exchange for stock; and (8) that in reply Downing stated [R. 75]—

> that the notes had been in his possession for a long period prior to December 31, 1929; that the notes

> had been cancelled in 1929 and that all legal steps had been taken for the issuance of the stock of the Chandis Securities Company prior to the close of 1929, but that the mechanical operation of issuing the certificates was delayed as the new certificates had not been received from the printer.

Revenue Agent Donnally states further in his affidavit that [R. 75]—

> on several visits to the office of the Chandis Securities Company for the purpose of examining the 1929 income tax return of Marian Otis Chandler he repeatedly requested from Mr. Downing that said notes be produced and was repeatedly told by Mr. Downing that the notes had been misplaced and that Mr. Downing was unable to produce them, but was repeatedly assured by Mr. Downing that the notes were cancelled in 1929 and that if they were found they would so indicate on their face. * * *

And that [R. 75-76]—

> he relied absolutely upon the statements of Mr. Downing that the notes had been misplaced and were not available, and that the notes had been cancelled in 1929 and would so indicate on their face if found, in preparing his recommendation to his superiors that the exchange of the notes for the stock was taxable in 1929.

Downing's affidavit of April 19, 1940 [R. 136-140], denies every material statement attributed to him in the

Donnally affidavit except that he had acted as Mrs. Chandler's representative in those interviews, and quotes from the transcript of his oral testimony given seven years earlier as a witness for the taxpayer at the hearing of her 1929 case before the Board of Tax Appeals. [R. 136-138.]

Conflicting statements were also presented at the hearing as between the affidavits of Revenue Agent Williams [R. 12-13, 76-79, and 148-149] and the affidavits of Downing [R. 24-37; and 150-151], as to the necessity for the Bureau to make the requested administrative examination into the taxpayer's 1930 income tax liability and the extent to which it should be limited, as will be developed hereinafter in the argument.

Specification of Errors and Points to Be Urged.

1. The District Court had jurisdiction to grant relief of the nature prayed in the petition.

2. The order and judgment entered by the District Court on June 10, 1940, is a "final decision" by the court which is subject to review by this Court on an appeal taken therefrom under the provisions of Section 128(a) of the Judicial Code as amended.

3. The District Court erred [R. 160-162]:

(a) In sustaining the appellant's motion to quash and in quashing and annulling its *ex parte* order made on March 5, 1940, for the production of records.

(b) In holding that under the petition and the various affidavits and documentary exhibits submitted at the hearing, appellant failed to make a sufficient showing of probable cause, sometimes called reasonable grounds for suspicion of fraud, to justify his requested re-examination of the appellee corporation's books and records reflecting its transactions with the stockholder taxpayer herein involved.

(c) In permitting appellees to raise in this proceeding (where the tax liability of neither appellee was before the court and the taxpayer is not a party and cannot be bound by any determination herein) any questions as to whether the Commissioner's requested examination of corporate records of Chandis and oral testimony of its assistant secretary respecting certain transactions with its chief stockholder, in order to determine that stockholder's individual income tax liability for the year 1930, is unreasonable, unnecessary, or precluded by the bar of limitation.

(d) In holding that the petition and the *ex parte* order for the production of books and records of Chandis were not limited sufficiently in point of time of transactions and in the number and scope of books and records designated for the requested administrative inquiry and examination.

(e) In holding and finally adjudging that appellant was not entitled to any relief against either appellee in this proceeding.

Summary of Argument.

1. Under plainly worded and applicable statutes the Commissioner, acting by appellant as his authorized field agent, had power and authority to issue this administrative summons and order for production of records under the internal revenue laws and the District Court is expressly given jurisdiction, by appropriate judicial process, to compel compliance with such administrative process. This legislation is to aid the Commissioner in his duty to properly administer the revenue laws.

2. This Court has jurisdiction, under the present appeal, to review the decision of the District Court herein. Technically speaking, that decision was rendered upon a motion to quash an *ex parte* order theretofore granting the relief prayed in the petition. However, it was rendered only after the respective parties, with the tacit approval of the trial court, had virtually submitted the entire controversy to that court for determination upon the merits. Upon the whole record the District Court ruled that appellant was not entitled to any relief against either appellee in this proceeding. The District Court then entered its order and judgment to that substantial effect, although not under that caption or label.

Under the spirit and intent of the new rules now governing civil procedure in the District Courts, that was a "final decision" by the District Court in this action. Hence that decision is subject to review in this Court upon an appeal taken therefrom under the provisions of Section 128(a) of the Judicial Code, as amended.

3. The Commissioner, acting through appellant as his authorized representative, has made a sufficient showing of probable cause, sometimes called reasonable ground for

suspicion of fraud, in connection with the 1930 income tax return of the taxpayer to entitle the Government to the relief prayed in its behalf under the petition.

Such showing of probable cause includes the personal affidavit of the taxpayer and other representations made in her behalf to the Bureau of Internal Revenue which misled the Bureau into treating the asserted interest income transactions now sought to be reinvestigated as having been culminated during the taxable year 1929 until after the statute of limitation had barred the assertion of a deficiency for 1930 upon the basis of that same transaction in the absence of fraud, also her failure to report that interest transaction in her returns for either 1929 or 1930. The opinion below fails to note the taxpayer's own affidavit in this connection.

The Commissioner has met the requirements provided under the internal revenue statutes by making the prescribed requests upon both the taxpayer and the appellee corporation for his local field agents to re-examine the taxpayer's 1930 income tax liability under his direction.

4. The taxpayer is not before the Court and cannot be bound by a determination here. Ample provision is made under the revenue laws for her "day in court" if and whenever the Commissioner of Internal Revenue should assert a deficiency of tax against her under a determination of fraud in connection with her 1930 income tax return. In that event, the taxpayer could appeal to the Board of Tax Appeals and thereby obtain a redetermination of the asserted deficiency prior to its collection. In such contingency she would have a very substantial strategic advantage that was not available to her under previous appeals to the Board in her 1923 and 1929 cases

involving the same asserted interest income under consideration herein. The Commissioner would be under the burden of both alleging and affirmatively proving the asserted fraud as a condition precedent to sustaining any 1930 tax deficiency against the taxpayer. However, such a burden is not imposed upon the Commissioner or his representatives acting in his behalf before that time.

Appellees are not in any position to challenge in this proceeding the propriety of the requested administrative examination of their records or to assert that such examination is unnecessary, unreasonable, in violation of the Federal Constitution or amendments thereto, or useless because of the possible availability to the taxpayer of the plea of limitation.

5. The list of corporate books and records sought to be examined herein looks rather formidable, but the actual number, quantity or volume of such corporate books and records is small enough for same to have been kept for an entire year in one safe belonging to another corporation.

All of those relatively few corporate records should be opened for examination by the Commissioner's agents in connection with his pending reinvestigation of the 1930 tax liability of the chief stockholder of this family corporation. This is especially true in view of the history of the interest-income transactions between them as shown by the record here and dating back almost to the organization of Chandis in 1916. The requested re-examination of all those records is necessary to enable the Commissioner to make ultimately a fair, complete and accurate administrative determination. It would not in fact subject appellees to any unreasonable or oppressive burdens under the showing made here.

ARGUMENT.

I.

The District Court Had Jurisdiction Under the Provisions of Section 3633, Internal Revenue Code, to Grant the Relief Prayed in the Petition.

From the petition and its supporting exhibits, it appears that (a) appellant is the Internal Revenue Agent in Charge at Los Angeles, California, and is the duly authorized field representative of the Commissioner of Internal Revenue to act in his behalf in the matters involved herein [R. 2-3, 8-9]; (b) both of the appellees reside in the City of Los Angeles, California, and within this judicial district [R. 4]; (c) that after Commissioner served the prescribed statutory written notice upon the taxpayer of the necessity to make a re-examination of pertinent records in order to verify the correctness of her 1930 income tax return, the interested parties denied his agents and representatives access to the pertinent and relevant records [R. 9, 25, 34-35]; (d) that the appellant, under the name and direction of the Commissioner issued and served an administrative summons and order upon appellees to submit the designated records for examination and give testimony relating thereto in the matter of the taxpayer's 1930 income tax liability [R. 5, 10] and both appellees refused to comply with that summons [R. 6-7]; (e) that appellant thereafter received the authorization and sanction of both the Commissioner and Attorney General of the United States to commence this proceeding [R. 2-3]; and (f) that appellant filed his petition in the district court of the district where the appellees reside praying for an order requiring the appellees to respond to the administrative summons and order in question [R. 2, 7-8].

In the course of the exercise by the Commissioner of his general power and duty under Section 3901(a)(1), Internal Revenue Code,[10] of "general superintendence of the assessment and collection of all taxes imposed" by the internal revenue laws, he was empowered and it was obviously his duty to direct all administrative examinations necessary to properly administer the revenue laws. Section 1105 of the Revenue Act of 1926, c. 27, 44 Stat. 9, which is the same as Section 3631, Internal Revenue Code, while providing against "unnecessary examinations", expressly provides that a re-examination may be made when "the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary". That statutory requirement was fully and meticulously met by the Commissioner and the appellant herein, as just pointed out above.

Section 3614, Internal Revenue Code [Appendix, *infra*] provides as follows:

> The Commissioner, for the purpose of ascertaining the correctness of any return * * * is authorized, by any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return, or of any officer or employee of such person, or * * * *of any other* person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in the return * * *. (Italics supplied.)

---

[10]Footnote 1, *supra.*

That statute is so plain, clear and unambiguous that it covers like a blanket the administrative process sought to be enforced by judicial process herein.

Furthermore, Section 3633, Internal Revenue Code, rather tersely confers jurisdiction upon the district court of the district where such a person resides, if "any person" is summoned under the internal revenue laws "to appear, to testify, or to produce records, papers or other data", to compel "by appropriate judicial process" such attendance, testimony or production of books, papers or other data.

The authorities construing these statutes clearly sustain the power of the Commissioner, acting through his authorized field agents, to issue administrative process of the nature and for the purpose shown herein, as well as the jurisdiction of the district courts (where the venue is propely laid, as here) to enforce such administrative investigatory process by sentence of contempt when the court orders that the parties respond to the summons and they still refuse to do so.

In *Brownson v. United States,* 32 Fed. (2d) 844 (C. C. A. 8), the court there said (p. 848):

> * * * the power granted to the Commissioner * * * by the statutes above quoted to require the attendance of witnesses and the production of books and papers in matters properly under investigation by him is similar to the power vested by analogous statutes in federal grand juries to perform similar acts, * * * and * * * the statutes involved, granting such power to the Commissioner, should receive a like liberal construction in view of the like important ends sought by the government.

There the superintendent of a local office of the Western Union Telegraph Company was required, under compul-

sion of judicial process, to appear and produce certain records relative to the taxpayer's receipt of certain money by wire. In the case of *In re Lyons,* 32 F. Supp. 92 (E.D. N.Y.) the authority of a revenue intelligence agent to issue and obtain judicial enforcement of a summons and order under Section 3614, Internal Revenue Code, was upheld in order to aid in determining the tax liability of a third party. See also *McCrone v. United States,* 307 U. S. 61, to the same effect. In affirming there a decision of this Court (100 Fed. (2d) 322), the Supreme Court said (p. 64):

> * * * Here, the summons served on petitioner required only that he testify in a tax inquiry properly conducted by an agent of the Bureau of Internal Revenue. And the agent's petition to the District Court, to which we may look in determining the nature of the proceeding, invoked judicial assistance solely in obtaining petitioner's testimony. Authority of the court was sought to buttress the procedure for collection of taxes and not in "vindication of the public justice," as in criminal cases.

There the person required by judicial process of the nature involved herein to appear and testify was also a third party and not the taxpayer.

Section 3740, Internal Revenue Code [Appendix, *infra*], provides that civil suits involving collection of internal revenue be commenced with the sanction and authorization of both the Commissioner of Internal Revenue and the Attorney General of the United States. This provision was also complied with. [R. 2-3.]

It is submitted that under the foregoing facts and authorities the jurisdiction of the District Court is so firmly established as to be beyond any serious challenge here.

II.

The Order and Judgment Entered by the District Court on June 10, 1940, Is a "Final Decision" by That Court Which Is Subject to Review on an Appeal Taken Therefrom to the Circuit Court of Appeals for the Ninth Circuit Within the Purview of Section 128(a) of the Judicial Code as Amended.

The only relief prayed in the petition was for an order to be issued by the trial court requiring the appellees to appear before the appellant at his office at the same time designated in his administrative summons and order to produce records and testify. [R. 7, 10-11.] Upon the filing of the petition the trial court issued an *ex parte* order directing appellant to do so. [R. 13-16.] Within the return day of that order as extended [R. 16-18] appellees moved to quash that order. [R. 19-24.] At the hearing upon that motion the parties submitted numerous affidavits and counter-affidavits, respectively asserting and denying the propriety of the relief prayed under the petition upon the merits thereof and supporting their respective positions by voluminous documentary exhibits also submitted at the same time. [R. 7-13, 73-79, 80-135, 141-147, 148-149 for appellant and R. 24-73, 136-140, 150-151, 165-221 and 222-256 for appellees.]

Under those affidavits (which were conflicting as to certain material factors in the case) and under the voluminous documentary exhibits and supporting same, the respective parties did not devote themselves to technical or procedural questions involving the jurisdiction of the trial court over the controversy or involving the manner in which relief had summarily been granted to appellant under the *ex parte* order. On the contrary, both parties,

> thereof) *will be offered in evidence at the hearing* of said motion, *and upon such other evidence as may be offered at said hearing.* (Italics supplied.)

All of the voluminous documentary evidence involving the merits of the whole controversy which was mentioned in that "Notice of Motion to Quash" was submitted by the parties and received and considered by the trial court before rendering his decision affectively denying appellant any and all relief prayed under the complaint.

Obviously it would have been extremely difficult under the old rules of Federal procedure to classify appellees' motion as either a motion to dismiss, a demurrer, a motion for certain interlocutory relief or an answer upon the merits, because it combined the features of all four of these motions or pleadings in one instrument. In fact, under the old rules almost any federal district judge, upon objection by the opposing party, would have stricken that pleading or motion or whatever it might be termed and required appellees to break it up into one, two or three separate or successive motions or pleadings.

However, under the present Federal Rules of Civil Procedure for the District Courts of the United States of America (the material provisions of which are set forth in the Appendix, *infra*) the parties by tacit agreement of counsel and with the approval of court could and did submit the whole controversy to the trial court in this somewhat unusual or hybrid manner in order "to secure the just, speedy and inexpensive determination of every action" within both the spirit and the letter of Rule 1, F. R. C. P., Appendix, *infra*.

Appellees could, under Rule 12(b)(6), [Appendix, *infra*] have moved to dismiss the petition for insufficiency of statement of claim. They might have filed an answer and then moved under Rule 12(c), [Appendix, *infra*] for judgment on the pleadings, or under Rule 56(b) [Appendix, *infra*] for summary judgment in their favor in whole or in part and with or without supporting affidavits. They could also have had their witnesses testify orally and presented their documentary evidence and submitted the case upon the regular trial calendar to the trial court without a jury under Rule 39(b) [Appendix, *infra*]. None of these present rules of federal procedure would have worked as effectively to bring the present case to a speedy and final determination in the trial court as the combined use of all of them has done.

Demurrers were abolished by Rule 7(c), F. R. C. P. [Appendix, *infra*], so we do not have here a situation of the nature which formerly arose when a demurrer to a complaint was sustained and the plaintiff undertook to appeal from that decision before the question of possible amendment to pleadings had been disposed of and formal order dismissing the complaint had been tentered. No order comparable to that was necessary here.

When the trial judge entered his order of June 10, 1940, it was obviously upon its face his final determination and judgment that appellant had failed upon the combined pleadings, motions and evidence to make out a case entitling him to any relief in this proceeding and that if the Bureau desired to pursue its administrative inquiry into Mrs. Chandler's 1930 tax liability any further, it would be necessary to file a new suit and start all over.

We submit as a matter of logic, common sense and practical interpretation of both the letter and the spirit of the new rules governing federal district court procedure that this order and judgment was a final decision by the District Court for the purpose of an appeal therefrom to this Court under the provisions of Section 128(a) of the Judicial Code, as amended.

The view just expressed also finds substantial support under the decisions involving cases arising under the old procedure, a few of which authorities are referred to here. As stated in *Ex Parte Norton,* 108 U. S. 237 at page 242—

> A decree is final for the purpose of appeal * * * when it terminates the litigation between the parties, and leaves nothing to be done but to enforce by execution what has been determined.

Under the peculiar and novel situation presented here there was not anything for appellees to enforce by execution after winning their lawsuit because they had completely and effectively stymied appellant from furthermore pursuing them in this particular proceeding unless and until the decision of Judge Yankwich should be reversed on appeal.

Bray v. Staples, 180 Fed. 321, 330 (C. C. A. 4th) states that the test for determining finality, and hence appealability, of the decision of a federal trial court—

> is not whether the cause remains *in fieri,* in some respects, awaiting further proceedings necessary to en-

> title the parties to the full measure of the rights it has been declared they have, but whether the decree * * * ascertains and determines these rights. *If these are ascertained and determined the decree is final.* (Italics supplied.)
>
> *City of Eau Claire v. Payson,* 107 Fed. 552, 557 (C. C. A. 7).
>
> The Supreme Court has not placed upon the words "final decree", respecting the right of appeal, a strict and technical sense, but has given them a liberal and reasonable construction.

And again in *Potter v. Beal,* 50 Fed. 860 (C. C. A. 1st) the syllabus states the rule thus:

> The question whether a decree is final and appealable is not determined by the name which the court below gives it but is to be decided by the appellate court on a consideration of the issue of what is done by the decree.

In view of the foregoing, we submit that the decision and judgment of the district court from which this appeal is taken is an appealable "final deciison" under Section 128(a) of the Judicial Code as amended [Appendix, *infra*] and that this Court has jurisdiction to review that judgment under appellant's present appeal.

III.

The Commissioner Made a Sufficient Showing of Probable Cause, Sometimes Called Reasonable Grounds for Suspicion of Fraud, to Justify His Requested Reexamination of the Appellee Corporation's Books and Records Reflecting Its Transactions With the Stockholder Taxpayer Herein Involved.

In a proceeding of this character the Government is under no burden either to allege fraud or to prove fraud upon the taxpayer's part. If the Commissioner had all the facts from which he could determine whether there was fraud in connection with the taxpayer's failure to report the large amount of asserted interest income in question, he never would have directed appellant to proceed with the reinvestigation of her 1930 income tax return, nor sanctioned the commencement of this proceeding. Whether there was such fraud is not before the Court. "The Government is merely seeking further information." *Zimmermann v. Wilson,* 105 F. (2d) 583, 585 (C. C. A. 3d), affirming second decision of the District Court, 25 F. Supp. 75 (E. D. Pa.).

The Commissioner is entitled to enforce obedience to the subpoena directed by his field agent to the appellee family corporation and its assistant secretary in order to obtain further light upon the above interest transactions between the appellees and the taxpayer which "might be fraudulent" upon the taxpayer's part, and which would justify a reexamination into her income producing transactions with the corporation after the statute of limitations had run in the taxpayer's favor in the absence of

such fraud. *Zimmermann v. Wilson* (C. C. A. 3d), *supra,* at p. 586. See also *In re Andrews' Tax Liability,* 18 F. Supp. 804 (Md.); *In re Upham's Income Tax,* 18 F. Supp. 737 (S. D. N. Y.); and *In re Keegan,* 18 F. Supp. 746 (S. D. N. Y.).

The striking analogy of the decision on the second appeal in the *Zimmermann* case to the present proceeding warrants some explanation here of the long litigation preceding that decision. In *Zimmermann v. Wilson,* unreported officially, but found in 16 A. F. T. R. 1070 (E. D. Pa.) (1935), the husband and wife sought to enjoin an examination by revenue agents of brokers' records of certain prior tax years upon the ground that the statute of limitations barred any assessment against the taxpayers for those years. The revenue agents merely moved to dismiss the bill of complaint, without filing an answer and raising any question of fraud; and the District Court dismissed the bill upon the grounds that the records were the property of the brokers and the taxpayer could not be heard to say whether the brokers would submit their records for an administrative examination. Upon appeal by the taxpayers, the Circuit Court of Appeals for the Third Circuit, in an opinion by Circuit Judges Buffington and Davis (who have both retired since then), reversed the decree dismissing the suit under the view that the taxpayers were the real parties in interest in the injunction suit and were entitled to a restraining order to prevent an examination, which, on the face of the bill of complaint, constituted "unreasonable search". *Zimmermann v. Wilson,* 81 F. (2d) 847. Upon remand of the case to the District Court the defendant revenue agents filed an answer raising the question of fraud. Upon the

second trial in the District Court upon bill, answer, and a hearing on the merits, that court dismissed the bill for an injunction and permitted an examination of the brokers' records. In that case the husband and wife had filed separate returns for the years 1929 and 1930, in which each had reported a number of sales of stock and claimed large losses by reason of such sales. Those returns had been audited by revenue agents in the years 1931 and 1932, respectively, and finally approved with some comparatively minor adjustments. After the period of limitation had run, the revenue agents discovered that some of those transactions were between husband and wife, although that fact had not been developed during the timely audit of their respective 1929 and 1930 returns. District Judge Kirkpatrick aptly stated the rule as follows (25 F. Supp. 75, 77):

> I have said that fraud is ultimately involved, but that does not mean that it must be proved in this suit. This is not a proceeding to collect a tax, in which fraud must be proved in order to escape the bar of the statute of limitations. What is involved here is the right to make an examination to determine whether or not there is sufficient reason to justify a proceeding to collect the tax.
>
> It seems plain that upon such an issue the Government need not prove fraud or even show a *prima facie* case. * * *

At the second hearing in the District Court, which was upon the merits, it was shown that Zimmermann and his wife had filed separate income tax returns for the years 1929 and 1930, which returns were duly approved by revenue agents who had full access to the books of Drexel

& Company, their stock brokers; that in 1933, and after ordinary assessment had become barred by the two-year limitation under Section 275(a) of the Revenue Act of 1928, [Appendix, *infra*], the agents had discovered upon a check of the books of another broker that certain sales of stock on which large losses had been taken appeared to be between husband and wife. At the time those returns were made there was no requirement that those taxpayers should disclose this fact, and the Zimmermanns had not done so in their returns. When the revenue agents sought further information from Drexel & Company, the latter refused them access to its records under the direction of the Zimmermanns; and the revenue agents were then stopped by a restraining order and preliminary injunction in the bill of complaint brought by the Zimmermanns from enforcing an administrative summons to Drexel similar to the one involved herein. A showing was made in the injunction suit that when the husband made sales of securities on which he had claimed and been allowed large losses, similar purchases in kind and quantity had been made for the wife's account by the husband acting as her agent and dealing through Drexel & Company, as brokers, on the same dates.

The Circuit Court of Appeals, in affirming District Judge Kirkpatrick's decision, recognized that the Bureau's examination must cover a wide field in cases involving transactions between husband and wife to avoid taxes, which were consummated through their stock brokers, and applied to that situation the rule which the District

The showing made by the appellant herein, as the Commissioner's agent, clearly brings this case within the rule announced in the foregoing authorities. Although the District Judge apparently recognized the correct principles applicable to the present situation, he clearly failed to apply these principles under his final disposition of the case.

District Judge Yankwich commented in his opinion herein upon a conflict between affidavits of the revenue agent and of the appellee Downing as to whether Downing had represented to the revenue agent that the transaction involving payment of notes and interest with shares of stock of the appellee corporation now under investigation was consummated during the taxable year 1929 and not in the taxable year 1930. [R. 155.] The District Judge, however, failed to note that the representations attributed by the revenue agent to the appellee Downing conformed completely to the taxpayer's own personal affidavit, which was submitted to the Bureau subsequently on December 17, 1931, in protest against the same revenue agent's report covering her 1929 return and in which she unequivocally represented to the Bureau that the same transaction had taken place "during the calendar year 1929". [R. 87-89.]

When the representatives, acting in the taxpayer's behalf, followed up the taxpayer's sworn protest and personal affidavit just mentioned with a letter to appellant dated March 28, 1932, they likewise referred to the exchange by the taxpayer and her children *on December 31, 1929,* of notes of the appellee corporation payable to those stockholder taxpayers of a face value, together with accrued interest aggregating $3,515,606.88, being then exchanged for 35,153 shares of stock of the appellee cor-

poration. Such agents challenged the taxability of that exchange upon grounds not material herein, but did not correct the taxpayer's own affidavit in any way as to the transaction having been consummated during 1929. [R. 90-91.]

On April 4, 1932, the former Internal Revenue Agent in Charge at Los Angeles advised the taxpayer by letter that he was forwarding her 1929 return, the agent's report and her protest to the Commissioner at Washington with the recommendation that a deficiency be asserted against her for that year upon the basis, *inter alia,* that she had received interest from Chandis during the calendar year 1929 in the sum of $661,369.56, as a result of the payment of her notes and accrued interest thereon in stock of Chandis under the transaction above mentioned. [R. 92-94.]

The Commissioner relied upon these representations in the taxpayer's own affidavit and the supplementary protest of her agent, when, on July 1, 1932 he issued a statutory sixty-day deficiency letter to the taxpayer for the year 1929 [R. 67, 69, 71], upon the basis that unreported asserted interest income of $661,369.56 had been received by the taxpayer during the year 1929 from Chandis as reported by the revenue agent. Similar notices of deficiencies for the year 1929 were likewise sent to the eight children of Mr. and Mrs. Chandler, who were also shareholders in the appellee corporation and situated similar to her in all respects except that they owned smaller numbers of shares of stock than she did. The taxpayer and the eight children all appealed to the Board of Tax Appeals. All nine of those appeals were consolidated and heard together by the Board. [R. 48-50.]

In the meantime, however, the taxpayer waited until August, 1933, or until just before the hearing of these cases before the Board, to give notice to the Commissioner's representative that the deficiencies would be resisted upon the ground that payment of the notes and interest in shares of stock had been consummated in 1930 and not in 1929. [R. 201-202.] Amended petition asserting that change in the position of the taxpayer was filed with the Board on September 25, 1933, and after certain new counsel had come into her case. [R. 201-202.]

The taxpayer had filed her 1930 income tax return on March 16, 1931, but she neither reported nor mentioned the above interest transaction in that return [R. 112-124]. (Neither had she mentioned it in her 1929 return as already brought out.)

In the absence of waiver, the Commissioner was allowed by Section 275(a) of the Revenue Act of 1928 [Appendix, *infra*], two years after that date or until March 16, 1933, to assert a deficiency against the taxpayer for that year and thereby test out the merits of his position and determination that this payment of notes and interest with stock of Chandis constituted a non-taxable exchange under Section 112(b) (5) of the Revenue Act of 1928—a question not material in this proceeding.

When the taxpayer waited until August, 1933, to change her position and attribute the interest-stock transaction to the taxable year 1930, the Commissioner was deprived of that right and put, without fault or neglect upon the part of himself or his agents, under the much more difficult burden of establishing fraud in connection with the taxpayer's 1930 return as a condition precedent to sustaining ultimately any deficiency of tax against her

for that year with respect to the asserted interest income item of $661,369.56, now under investigation. Section 276(a), Revenue Act of 1928. [Appendix, *infra.*]

In the taxpayer's own affidavit of December 17, 1931, above mentioned, she stated as follows [R. 87-89]:

> (2) The year involved is the calendar year 1929 * * *.
>
> * * * * * * * *
>
> (4) The facts upon which the taxpayer relies in support of her contentions are as follows:
>
> (a) The taxpayer is a stockholder in the Chandis Securities Company and during the calendar year 1929 and prior thereto was the payee under certain promissory notes signed by the Chandis Securities Company.
>
> (1) *During the calendar year 1929,* the *Chandis Securities Company* in connection with a reorganization, *acquired from this taxpayer the notes of the said Company held by the taxpayer.*
>
> (2) At the time the notes were acquired, interest had accrued in the sum of $70,097.32. The Internal Revenue Agent has erroneously included this sum as income which was not paid to the taxpayer and was not credited to her account or unqualifiedly subject to her demand. It is the contention of the taxpayer that the transaction whereby the taxpayer transferred notes to the Chandis Securities Company for its stock represents an exempt exchange in connection with a reorganization. (Italics supplied.)

The closing balance sheet of Chandis as of December 31, 1929, as put in evidence before the Board, showed that the notes and accrued interest thereon were listed as liabilities of the corporation at the close of that year [R. 193-194]. However, it was stipulated by counsel in that proceeding that Chandis "did not deduct any interest on the notes in question after the year 1929 and that no interest was accrued on the books of the corporation, in respect of the notes, after 1929". [R. 200.]

We have already set forth (1) how and when Chandis was organized, (2) its capital structure, (3) the acquisition by the taxpayer and the children of the first series of promissory notes now in question, (4) the Commissioner's unsuccessful attempt to tax the shareholder payees of those notes with interest added into the face of the renewal notes given December 23, 1923, (5) other phases of the situation leading up to the Commissioner's unsuccessful attempt to tax the asserted interest income as 1929 income of the taxpayer and her children when they accepted shares of stock in settlement and payment of principal and interest accrued to December 31, 1929, upon renewal notes bearing compound interest then held by them, those notes and (6) how Chandis over the years 1918 to 1929, inclusive, deducted from its gross income as a business expense interest upon both series of notes aggregating approximately $1,500,000, without the Commissioner being successful in his attempts to tax any of that interest to the recipient stockholders for any taxable year to date.

We have also shown that during the period under investigation and inquiry by the Commissioner the appellee Downing acted in the joint capacity of secretary for and custodian of all the records of Chandis involving the above interest transactions with the taxpayer and as the taxpayer's individual representative when Revenue Agent Donnally was making the original field examination of her 1929 return. We put in evidence at the hearing below (1) Mrs. Chandler's own affidavit which was susceptible of only one construction—that the interest-stock transaction in question was consummated in 1929; the affidavit of agent Donnally that Downing upon a certain excuse failed to produce the cancelled notes on stock records to speak for themselves when, in response to a direct inquiry from the agent, Downing had stated the whole transaction was consummated in 1929 and the records would so show if he had then been able to produce them. We have the revenue agent's report to his superior officers about that time of that interview in which the agent reported the interest-stock transaction as a 1929 transaction in his recomputation of the taxpayer's 1929 income. [R. 80, 82-83.] We also have the taxpayer's failure to report or mention the item in her 1930 return in any way [R. 112-124] and her change of position in her 1929 case before the Board after the ordinary statute of limitations barred a 1930 deficiency against the taxpayer.

It was not necessary for the trial judge upon the hearing to resolve the issue of veracity as between agent

Donnally and Downing as to whether Downing actually made the misrepresentations of fact about the interest-stock transaction being consummated in 1929, because the trial court was not required to try the issue of actual fraud herein.

It is submitted that under the pleadings, affidavits and all the evidence of a voluminous documentary nature submitted at the hearing, the District Court erred in failing or refusing to hold that the Commissioner had made a showing of probable cause or reasonable ground for suspicion of fraud that was sufficient to entitle him to proceed with his administrative re-examination into the 1930 income tax liability of Mrs. Chandler.[12]

---

[12]In view of the manner in which this case went off in the District Court, appellant does not occupy here the position of a litigant seeking to challenge the sufficiency of evidence to support special findings of fact made by a District Judge with full opportunity to see, hear and observe the witnesses when they gave conflicting testimony at a regular hearing upon the merits. We agree that it is not the function of this Court to weigh the evidence in such cases. *Cf. Atlas Beverage Co. v. Minneapolis Brewing Co.,* 113 F. (2d) 672 (C. C. A. 8th); *Schneiderman v. United States,* 119 F. (2d) 500 (C. C. A. 9th). In the present proceeding the District Judge neither saw nor heard a single witness testify. He neither made, nor was required to make, any special findings of fact. He actually ruled, in substance and effect, as he would have done if the case had been submitted to him upon a motion to dismiss or for summary judgment, with supporting and opposing affidavits and exhibits. If that had been the actual procedural situation here, this Court could certainly examine the petition, with its supporting affidavits and exhibits, and the documentary evidence submitted at the hearing, and determine for itself the question of law whether, on the whole record, appellant is entitled to any relief in this proceeding, or whether the District Judge should have set the case down for hearing upon the merits by reason of some genuine and material issue of fact having developed at the hearing upon such a motion. *Cf. Thomas v. Peyser,* 118 F. (2d) 369 (App. D. C.); *Lucking v. Dalano,* 122 F. (2d) 21 App. D. C., and *Wyant v. Crittenden,* 113 F. (2d) 170 (App. D. C.).

Neither the Appellee Corporation nor Its Assistant Secretary Is in a Position to Raise Any Question in This Proceeding as to Whether the Commissioner's Requested Examination of Its Corporate Records of Transactions With Its Chief Stockholder Is Unreasonable, Unnecessary, or Futile Because of the Limitation Against Assessment of a Deficiency, Where the Taxpayer Is Not Before the Court and, Concededly, Cannot Be Bound by Any Determination Herein.

This proceeding is merely one of an ancillary nature. The taxpayer is not a party. There is no occasion for her ever being brought in as a party. No relief is sought against her directly or indirectly. She cannot be bound by any determination herein. The Commissioner cannot now assert a tax deficiency against her for the year 1930 except in case of fraud as permitted under Section 276(a), Internal Revenue Code. [Appendix, *infra.*] If and whenever he should attempt to do so she will have the same right of appeal to the Board of Tax Appeals which she has already exercised successfully with respect to the taxable years 1920-1923 and 1929.[13] In any such event the Commissioner will have the burden of affirmatively establishing fraud in order to test out on the merits his position that the payment of interest in stock of Chandis constituted the receipt of income by the taxpayer. Sec-

---

[13]*Chandler v. Commissioner,* 16 B. T. A. 1248, 1249, *supra,* covers 1920-1923, inclusive, and *Chandler v. Commissioner,* 32 B. T. A. 720, affirmed as *Commissioner v. Chandler,* 89 F. (2d) 332 (C. C. A. 9th), *supra,* cover the year 1929.

tion 1112, Internal Revenue Code, expressly imposes such a burden upon the Commissioner by providing as follows:

> In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner. (U. S. C., Supp. V, Title 26, Sec. 1112.)

There is no basis for meritorious objection to the enforcement of the administrative process now in question upon the ground of its being unreasonable, unnecessary, untimely or oppressive, so far as the taxpayer is concerned, where no burden can be imposed directly or indirectly upon her through its enforcement. The appellee third parties are not in any position to raise any such question in her behalf in a proceeding of this kind. *Zimmermann v. Wilson,* 105 F. (2d) 583 (C. C. A. 3d), *supra; In re Upham's Income Tax,* 18 F. Supp. 737 (S. D. N. Y.), *supra; In re Keegan,* 18 F. Supp. 746 (S. D. N. Y.), *supra.*

The case of *Caplis v. Helvering,* 4 F. Supp. 181 (E. D. N. Y.), was a suit by a third party who had acted as attorney for the taxpayer prior to the latter's death to restrain a field officer of the Bureau of Internal Revenue from conducting an administrative investigation into the tax liability of the decedent's estate. Caplis there asserted unsuccessfully all the constitutional and other defenses, including the bar of statute of limitation, as have been raised by appellees while occupying the position of

third parties here. With particular reference to the attempt by a party other than the taxpayer to inject the limitation question in that case the court there, in denying the injunction, very aptly said (p. 183):

> So far as insistence is had on the statute of limitation as a bar, it may be said that it does not lie in the mouth of plaintiff to assert that the statute of limitations has run against the Phillips estate. Conceivably, such a defense might be asserted by the representatives of that estate in an action brought by the United States government against them.

The same rule is applied in suits by the United States against banks or other third parties holding funds or other property of a delinquent taxpayer and refusing to turn over such funds or property when served with a warrant of distraint. The third party is not permitted in any such proceeding to plead that collection of the tax is barred by limitation or to assert any other defense to show the tax is not due, since ample provision is made under the revenue laws in which the taxpayer may have his "day in court" under a claim and direct suit for refund of taxes illegally collected if he wants to test out the question of collection after the bar of limitation. (*Cf. United States v. American Exchange Irving Trust Co.*, 43 F. (2d) 829 (S. D. N. Y.); *United States v. First Capital Nat. Bank*, 89 F. (2d) 116 (C. C. A. 8th).)

V.

The Commissioner Should Not Be Limited in His Examination Either as to Particular Books and Records of the Appellee Corporation or as to the Time of Transactions Leading Up to or Forming Part of Those Between the Taxpayer and the Corporation Which Are Now in Question by Reason of Such Transactions Having Occurred Prior to Any Fixed, Arbitrary Date.

As already pointed out, Chandis was organized in 1916 when Harry Chandler, husband of the taxpayer, paid for its original issue of 500 shares of stock of aggregate par value of $500,000 by transferring various investment properties and securities to Chandis in payment for its stock and causing the stock to be issued in proportions of 40% to his wife (the taxpayer here), 56% in equal proportions to his eight children, and the remaining 4% to himself. Shortly after its organization he began transferring other properties to Chandis, taking its interest-bearing notes in exchange for such properties, and transferring the notes to his wife and children in proportion to their stockholdings. [R. 50-51.]

On or about December 31, 1923, Chandis charged on its books as a corporate liability and expense all of the interest which had accrued upon this first series of notes held by Mrs. Chandler and the children over the immediately preceding six years or as far back as the year 1918, and credited that simple interest to the accounts of those respective individuals. [R. 59-60.] Chandis gave renewal notes dated December 31, 1923, to the respective noteholders with the interest thus accrued upon the old notes to that date added into the face of the new notes maturing December 31, 1929 [R. 44-45, 51-52],

which new notes bore 5% annual interest, compounded annually. [R. 53.] Chandis has accrued the compound interest annually upon its books over the years 1924-1929, inclusive, and taken that aggregate interest deduction of $875,008.67 from its income for the years 1924-1929, inclusive. [R. 51-52, 55.] The interest which accrued against Chandis prior to and including December 31, 1923, amounted to the aggregate sum of $702,049.61 [R. 51], when those notes were surrendered on that date and new ones given maturing December 31, 1928. All of that interest was set up on the books of Chandis on or about December 31, 1923, as an accrued expense and liability and correspondingly credited to the accounts of the taxpayer and the children as the basis for the renewal notes then given. [R. 60, 51-52.] Apparently, that entire accrued interest item of $702,049.61 was deducted from income of Chandis in its return for the calendar year 1923, without the propriety of such deduction being challenged by the Commissioner.[14]

The Commissioner has made two unsuccessful attempts to tax as interest income to the shareholders of Chandis the amounts corresponding to interest thus deducted by the corporation over that long period of not less than the aggregate sum of $1,577,058.67 ($702,049.61 accrued to December 31, 1923, on the first series of notes [R. 51], plus $875,008.67 accrued thereafter through December 31,

---

[14]In the income tax return filed by Chandis for the calendar year 1923, it claimed a deduction from gross income for interest expense in the aggregate sum of $738,577.33, and reported a net loss for that year of $618,270.74, and the Commissioner upon audit of that return never assessed any deficiency against the appellee corporation for that year. [R. 125.] From the balance sheet made schedule K to that return, it further appears that the appellee corporation's liability on account of notes payable was $2,162,074.01 on January 1, 1923, and that this liability had increased to $2,825,843.28 on December 31, 1923. [R. 128.]

1929, upon the second series of notes. [R. 52]). The taxpayer's share of that aggregate interest, is conceded in her amended petition before the Board of Tax Appeals in her 1929 case to have been $661,369.56. [R. 168.] The second series of notes, maturing December 31, 1929, in the aggregate principal of $2,640,598.21, plus compound interest accrued thereon to December 31, 1929 of $875,008.67 [R. 52], was found by the Board of Tax Appeals, with the affirmance of this Court, to have been surrendered and canceled during the year 1930, in consideration of the issuance of additional shares of stock of Chandis of the aggregate par value of $3,515,600. [R. 56.]

During the year 1929, the appellee Downing was secretary of the appellee corporation, and his particular function was taking care of its financial records. [R. 201.] When the taxpayer's individual 1929 return was under investigation by the Bureau, he also acted as her individual tax agent or representative. [R. 74, 136.] He so admitted in the 1929 case before the Board. The Board found that all of the promissory notes payable to the taxpayer and the eight children were in his custody throughout the entire taxable year 1929. [R. 55, 197.] He also admitted that during the entire year 1929, he kept all the notes, together with all the books and records of Chandis relating to its financial transactions since its organization in one safe; that the safe belonged to the Times Mirror Company; and that his office and that safe were in an office of the Times Mirror Company, which was assigned by that company to Chandis for the transaction of the latter's business. [R. 197.]

The list of records of Chandis required to reflect the complete history of the interest transactions now under

investigation would appear to be rather formidable. [R. 5, 19-20.] However, the actual volume of all such records sought to be investigated herein is comparatively small in kind and quantity. Chandis is not an operating concern. It is only a family holding or investment corporation. All of the records reflecting its financial transactions were thus kept in one safe during the entire year 1929, and are probably kept at present in a receptacle no larger than that. The contention urged with some success by appellees in the court below that an examination of any or all of these records would impose a hardship upon the appellees is clearly without merit.

The Supreme Court in recent years has shown a rather decided tendency to uphold the Commissioner when he scrutinizes closely transactions between an individual stockholder and a controlled or family corporation for the purpose of determining whether such transactions are what they purport to be on the surface or had a different substance and hence different tax consequences. *Cf. Gregory v. Helvering,* 293 U. S. 465; *Higgins v. Smith,* 308 U. S. 473, and *Griffiths v. Commissioner,* 308 U. S. 355. Chandis has already had the benefit of deductions from its own gross income with respect to the interest transactions between itself and its principal stockholder now under investigation. Surely the Commissioner is now entitled to the aid of the courts in this proceeding where his sole purpose is to enable him to ascertain and determine the real substance and tax consequences of this same long series of interest transactions and also to determine whether the taxpayer has been guilty of fraud in connection with her failure to report taxable income for the year 1930.

The Commissioner should have the opportunity to check fully into the matter of how, when and at what cost the various properties held by the appellee corporation at the end of its taxable year 1929 were acquired, as a part of the requested administrative re-examination of records. This is needed in order to determine the value of the stock which the taxpayer accepted in payment of interest. The Commissioner should not be limited with respect to that phase of the case to the list of securities or properties appearing in the balance sheet of Chandis on December 31, 1929.

Furthermore, it is not practicable to draw an arbitrary line for the purpose of limiting the Commissioner's investigation to transactions occurring after a particular date somewhere between 1916 and 1930, or to particular corporate books and records without hampering and restricting the Commissioner in the investigation now sought to be made by him.

In the light of the whole picture presented by the record, the Commissioner should be entitled to examine into all of the corporate books and records described in the petition, and an order and direction by the Court to that effect will not impose any arbitrary, oppressive or unreasonable burden upon either of the appellees.

Conclusion.

(a) The District Court had jurisdiction under the provisions of Section 3633, Internal Revenue Code, to grant the relief herein prayed.

(b) The order and judgment entered by the District Court on June 10, 1940, is a "final decision" by that court which is subject to review here upon an appeal

taken therefrom under the provisions of Section 128(a) of the Judicial Code as amended.

(c) The final decision of the District Court should be versed and set aside, and its earlier order for the production and examination of records should be reinstated and made final.

(d) In any event, the final decision of the District Court should be modified so that the Commissioner will not be limited either as to the particular books and records of the appellee corporation subject to production and examination or as to the time of transactions leading up to or forming part of those between the taxpayer and the appellee corporation subject to investigation.

Respectfully submitted,

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

HELEN R. CARLOSS,
FRANK J. READY,
Special Assistants to the Attorney General.

WILLIAM FLEET PALMER,
United States Attorney.

E. H. MITCHELL,
Assistant United States Attorney.

EUGENE HARPOLE,
Special Attorney, Bureau of Internal Revenue.

SAMUEL TAYLOR,
Special Attorney, Bureau of Internal Revenue.

March 16, 1942.

APPENDIX.

Internal Revenue Code:

SEC. 3614. EXAMINATION OF BOOKS AND WITNESSES.

(a) *To Determine Liability of the Taxpayer.*— The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is authorized, by any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

* * * * * * * * *

(U. S. C., Supp. V, Title 26, Sec. 3614.)

SEC. 3631. RESTRICTIONS ON EXAMINATION OF TAXPAYERS.

No taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation,

notifies the taxpayer in writing that an additional inspection is necessary.

(U. S. C., Supp. V, Title 26, Sec. 3631.)

SEC. 3633. JURISDICTION OF DISTRICT COURTS.

(a) *To Enforce Summons.*—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

* * * * * * * * *

(U. S. C., Supp. V, Title 26, Sec. 3633.)

SEC. 3740. No suit for the recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Commissioner authorizes or sanctions the proceedings and the Attorney General directs that the suit be commenced.

(U. S. C., Supp. V, Title 26, Sec. 3740.)

Judicial Code, as Amended:

128(a). The circuit courts of appeal shall have appellate jurisdiction to review by appeal final decisions—

First. In the district courts, in all cases save where a direct review of the decision may be had in the Supreme Court under section 238. * * *

(U. S. C., Title 28, Sec. 225.)

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General rule.*—The amount of income taxes imposed by this title shall be assessed within two years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * * * * * *

SEC. 276. Same—EXCEPTIONS.

(a) *False return or no return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * * * * * *

Rules of Civil Procedure for the District Courts of the United States.

Rule 1. * * *. These rules govern the procedure in the district courts of the United States in all suits of a civil nature whether cognizable as cases at law or in equity * * *. They shall be construed to secure the jus, speedy and inexpensive determination of every action.

Rule 7. * * *.

(c) * * *. Demurrers, pleas, and exceptions for insufficiency of a pleading shall not be used.

Rule 10. * * *.

(c) * * *. Statements in a pleading may be adopted by reference in a different part of the same pleading or in another pleading or in any motion. A copy of any written instrument which is an exhibit to a pleading is a part thereof for all purposes.

Rule 12. Defenses and Objections. * * *.

(b) How Presented. Every defense * * * to a claim for relief in any pleading, whether a claim * * * shall be asserted in the responsive pleading thereto * * * except that the following defenses may * * * be made by motion: * * * (6) failure to state a claim upon which relief can be granted. * * * No defense or objection is waived by being joined with one or more defenses or objections in a responsive pleading or motion. * * *.

(c) Motion for Judgment on the Pleadings. After the pleadings are closed * * * any party may move for judgment on the pleadings.

Rule 39. Trial by Jury or by the Court. * * *.

(b) By the Court: Issues not demanded for trial by jury * * * shall be tried by the court * * *.

Rule 56. Summary Judgment. * * *.

(b) For Defending Party. A party against whom a claim * * * is asserted * * * may * * * move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.